(7)

No. 92-1384

In The

Supreme Court of the United States

October Term, 1992

BARCLAYS BANK PLC,

Petitioner,

v.

FRANCHISE TAX BOARD,
An Agency of the State of California,

Respondent.

**On Petition For A Writ Of Certiorari
To The Court Of Appeal
Of The State Of California
In And For The Third Appellate District**

BRIEF OF RESPONDENT FRANCHISE TAX BOARD IN OPPOSITION TO PETITION FOR WRIT OF CERTIORARI

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QUESTIONS PRESENTED

1. Whether the California Supreme Court properly declined to apply a dormant Commerce Clause analysis and properly held that, due to congressional acquiescence, California did not violate the Foreign Commerce Clause by application of worldwide combined reporting to determine the taxable California income of the Barclays taxpayers.

2. If a dormant Commerce Clause analysis were appropriate, would California's use of worldwide combined reporting violate the discrimination element of such a dormant analysis even though California applied the same tax and reporting requirements upon all taxpayers, whether their multinational group was headed by a foreign or a domestic parent corporation?

3. Even though California's practice is held to be valid under the Foreign Commerce Clause, whether California's application of worldwide combined reporting to the Barclays taxpayers is nevertheless preempted by the United States Constitution as an intrusion into an inherently federal area; specifically, whether the Executive Branch's foreign affairs powers can eclipse Congress' exercise of its treaty and Commerce Clause powers to permit such state use of worldwide combined reporting.

4. Whether California's tax reporting procedures, which permit taxpayers to avoid high compliance expenses through the use of reasonable approximations, and which provide for court review of any claimed abuse of administrative discretion, deny taxpayers due process of law.

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STATUTORY AND CONSTITUTIONAL PROVISIONS

Petitioner Barclays has included some of the relevant constitutional and statutory provisions in Appendix F to the petition. Petitioner also sets forth the applicable regulation (California Code of Regulations title 18, section 25137-6) as Appendix J to its petition. Appendix A to this brief in response contains the following: a portion of

article II, section 2 of the United States Constitution and California Revenue and Taxation Code section 25110.

SUPPLEMENTAL STATEMENT OF THE CASE

Respondent Franchise Tax Board believes that petitioner Barclays' statement regarding the case (Petition for Certiorari ("Pet.") 4-13) contains significant omissions. Therefore, pursuant to Rule 15.1, the Franchise Tax Board provides this Court with this supplemental statement. This supplement should be read in conjunction with and in addition to both Barclays' statement and the California Supreme Court's statement of the factual, procedural, legislative and case law background, which is included herein by reference. Most citations herein are to the appendices to the Petition for Writ of Certiorari (for example, "A-38" is a citation to page 38 of Appendix A to the petition).

1. Petitioner's California Tax Filings and the Franchise Tax Board's Adjustments.

The Barclays Group conducted its business in California through two corporate entities during the year in issue. Barclays Bank of California ("Barcal"), a wholly owned, California incorporated, subsidiary of Barclays Bank International ("BBI"), conducted a commercial banking business in the State of California. A-38, ¶ 9. BBI, a wholly owned, United Kingdom incorporated, subsidiary of Barclays Bank Limited ("BBL"), conducted business in California as a banking agency. A-36, ¶ 1. BBI was

engaged in general retail and commercial banking, leasing, and consumer and commercial finance, directly or through subsidiaries, in approximately fifty-five (55) countries and territories during 1977. A-37, ¶ 2.

Both corporations filed California Franchise Tax returns for the year at issue. Barcal filed a return which included in its calculations only its individual income and activities. A-39-40, ¶ 19. BBI filed a return based upon a worldwide combined report which included all of its worldwide income and activities, and the worldwide income and activities of all of its controlled subsidiaries, including Barcal. A-39, ¶ 18. The income which served as a measure of BBI's California tax was determined by applying an apportionment formula (which compared BBI's California activities to the worldwide activities of BBI and its subsidiaries) to the worldwide net income of BBI and its subsidiaries.[1]

At audit, the Franchise Tax Board determined that Barcal, BBI and all of BBI's other subsidiaries were part of a single unitary business which also included BBL, the parent company of BBI, and all of the other controlled subsidiaries of BBL. A-38, ¶ 14. As a result of this determination, the Franchise Tax Board recomputed the California tax liabilities of Barcal and BBI upon the basis of a combined report which included all of the income and

[1] The California Court of Appeal recognized that the actual cost to BBI of filing such a return on a worldwide apportionment basis, using reasonable approximations, was "relatively modest," referring to earlier costs "on the order of $900 to $1,250 per year for three annual tax returns filed in the 1970's." D-19 and n. 9.

activities of the entities determined to be in the unitary business, from which the California net incomes of Barcal and BBI were calculated by formulary apportionment. A-38, ¶ 15; A-39, ¶ 16; C-5. For purposes of this litigation it is agreed that BBL and all of its majority-owned subsidiaries, including BBI and Barcal, are a single unitary business. C-2, A-37 ¶ 8, A-42 ¶ 27.

BBI and Barcal pursued administrative remedies with the Franchise Tax Board, and modifications were made to the original audit calculations of the amount of income attributed to California. BBI and Barcal paid the modified assessments, and both filed suits for refund asking for the return of all tax and interest amounts paid which were over the amounts paid with their original returns. Neither BBI (A-41, ¶ 25) nor Barcal (A-41, ¶ 24) has claimed that the amount of tax paid with their original returns was erroneous.

2. Awareness of the Use of the Worldwide Combined Report Method of Determining Income.

There is evidence which suggests international awareness of the use of formula apportionment and the unitary method at least from the mid-1950's onward. C-33. As early as the late 1940's the United States negotiators of Friendship, Commerce and Navigation agreements recognized the existence of formulary approaches. C-33 to C-34. The use of formula apportionment as an alternative to the arm's-length/separate accounting method penetrated the international financial and diplomatic consciousness as early as 1924. C-32.

The debate regarding the States' use of worldwide combined reporting ("WWCR") methodologies was recognized by the Executive Branch of the federal government as spanning at least two decades as of 1984. C-33, n. 14. From at least as far back as 1965, Congressional bills dealing with the subject of the States' use of WWCR have been introduced (C-31); these have included measures sponsored by the United States Treasury. For over 25 years, senior tax and foreign policy officials of the Executive Branch had been aware of the complaints and demands of foreign governments regarding worldwide combined reporting. C-27.

3. The United States/United Kingdom Tax Treaty.

In 1975, the Ford administration negotiated a bilateral income tax convention ("US/UK Treaty") with the United Kingdom which would have prevented the use of the WWCR methodology here at issue. C-28. In 1978, with explicit recognition of the "negative implications" of its act, the United States Senate *rejected* the US/UK Treaty as negotiated by the Executive Branch. C-27. The treaty was approved only after the provision prohibiting the states' use of worldwide combined reporting was removed. C-27. In the wake of that Senate rejection, the Executive Branch scuttled its effort to achieve a treaty-imposed curb on the states' use of WWCR. C-28 and C-37, n. 20.

The Parliament of the United Kingdom ratified the treaty, without the clause prohibiting the states' use of WWCR, in 1980. C-30, n. 11 and A-56, ¶ 40gg. The ratification occurred after representatives of the two countries negotiated the Third Protocol to the Treaty. A-56,

¶ 40gg. The government of the United Kingdom, while regretting the defeat of the prohibition as preliminarily negotiated in 1975, recognized that the US/UK Treaty as finally negotiated and ratified was "a fair and balanced agreement." A-44, ¶ 32c; Exh. 32c.

In 1985 Parliament enacted legislation which empowered the Prime Minister to institute retaliatory taxation against United States companies if the use of WWCR was continued. A-49, ¶ 34. This power has never been exercised. The Executive Branch has indicated to Congress that exercising this power would constitute a clear violation of the treaty by the United Kingdom. Exh. 37i, p. 12.

4. The California Water's-Edge Election.

In 1986 California enacted legislation which allows both foreign and domestic based businesses to elect out of the use of WWCR in favor of a "water's-edge" method, which in general confines WWCR to United States incorporated entities, certain tax advantage subsidiaries of United States corporations and, in limited circumstances, some portion of foreign incorporated entities. C-36 and A-73, ¶ 55; Cal. Revenue and Taxation Code § 25110 (see Appendix A hereto). The enactment of the California water's-edge legislation prompted senior Treasury officials to retreat from their previous insistence that Congress prohibit state use of worldwide formula apportionment. C-36 to C-37.

5. This Court's Recognition of the Merits of Formulary Apportionment.

As noted above, worldwide combined reporting is based upon formulary apportionment of the total net income of a unitary business. Use of such formula apportionment of income does not result in taxation of non-California corporations or in taxation of non-California income; it is only the means of determining what portion of the unitary income can be fairly attributed to the part of the unitary business that is actually being carried out in California. *Container Corporation* v. *Franchise Tax Board*, 463 U.S. 159, 164-65, 184, 192 (1983) (hereinafter "*Container*").

The *Container* decision, *id.*, upheld the constitutionality of California's use of unitary apportionment and WWCR as to worldwide unitary businesses headed by domestic corporations. In *Container*, this Court held California's version of WWCR to be a "proper and fair method of taxation" (463 U.S. at 184) which reflects "a reasonable sense of how income is generated" (*id.* at 169-70) and which avoids the "basic theoretical weaknesses" of arm's length/separate accounting methods (*id.* at 181), the alternative to WWCR which petitioner Barclays claims must be applied to the Barclays taxpayers. Among the separate accounting weaknesses pointed out in *Container* are that separate accounting "is subject to manipulation and imprecision, and often ignores or captures inadequately the many subtle and largely unquantifiable transfers of value that take place among the components of a single enterprise" (*id.* at 164-65).

As this Court stated in *Trinova Corp.* v. *Michigan Dept. of Treasury*, ___ U.S. ___, 111 S.Ct. 818, 831 (1991), "since *Underwood Typewriter Co.* v. *Chamberlain*, 254 U.S. 113 (1920), we have recognized the impracticability of assuming that all income can be assigned [by geographic designation] to a single source." As this Court has very recently stated, "The principal virtue of the unitary business principle of taxation is that it does a better job of accounting for 'the many subtle and largely unquantifiable transfers of value that take place among the components of a single enterprise' than, for example, geographical or transactional accounting." *Allied-Signal, Inc.* v. *Director, Div. of Taxation*, ___ U.S. ___, 112 S.Ct. 2251, 2261 (1992).

ARGUMENT

I

THE CALIFORNIA SUPREME COURT HAS PROPERLY APPLIED THIS COURT'S *WARDAIR* DECISION IN HOLDING THAT CONGRESSIONAL ACQUIESCENCE IN CALIFORNIA'S USE OF WORLDWIDE COMBINED REPORTING IS DETERMINATIVE OF THE COMMERCE CLAUSE ISSUE, WITH NO NEED FOR ANY DORMANT COMMERCE CLAUSE ANALYSIS.

The California Supreme Court has correctly applied existing precedent of this Court in a manner fully consistent with this Court's February 1993 holding in *Itel Containers International Corp.* v. *Huddleston*, ___ U.S. ___, 113 S.Ct. 1095 (1993), the most recent Foreign Commerce

Clause tax case. There is no need for this Court to exercise its jurisdiction to revisit this constitutional area at this time.

The California Supreme Court's Commerce Clause holding, based upon *Wardair Canada, Inc.* v. *Florida Dept. of Revenue*, 477 U.S. 1 (1986) (hereinafter "*Wardair*"), concludes that congressional actions show that Congress has acquiesced in the state tax practice which Barclays is challenging. That being so, the California Supreme Court pointedly did not engage in any dormant Commerce Clause analysis. C-39. Most of Barclays' petition is devoted to assertions which are relevant only to a dormant Commerce Clause analysis. Other than a few citations to *Wardair*, Barclays confines its non-dormant Commerce Clause contentions to several pages near the end of its Commerce Clause argument. Pet. 20-23.

In *Wardair* this Court cautioned that "It would turn dormant Commerce Clause analysis entirely upside down to apply it when the Federal Government has acted, and to apply it in such a way as to reverse the policy that the Federal Government has elected to follow." *Id.* at 12. By criticizing the California Supreme Court for "disregard[ing]" established dormant Commerce Clause criteria (Pet. 16) in a case where Congress has acted to allow the state tax practice in issue, it appears that the Barclays petition would have this Court require a dormant Commerce Clause analysis even when the empowered branch

of the Federal Government has acted to permit the challenged state tax.[2]

In *Container Corp. of America* v. *Franchise Tax Board*, 463 U.S. 159 (1982) (hereinafter "*Container*"), this Court upheld the constitutionality of California's worldwide combined reporting method as applied to a multinational unitary business with a domestic ultimate parent. This Court reserved the question of whether it would reach the same result if (as in this case) the ultimate parent corporation were foreign. 463 U.S. at 193-97.[3]

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[2] There is no need or basis to apply in this case the results of dormant Commerce Clause analysis from such cases as *Kraft General Foods* v. *Iowa Dept. of Revenue*, ___ U.S. ___, 112 S.Ct. 2365 (1992), cited Pet. at 13, 15, 18 n. 18, and 23. The fact that the dormant Commerce Clause analysis is broadened by two additional elements in the foreign commerce context as compared to the domestic context (*id.* at 2370) cannot affect Congress' total power to remove *all* Commerce Clause restrictions upon any state tax practice in which Congress chooses to acquiesce. See also n. 5 below at p. 14.

[3] When dealing with the question of the "one voice" of the federal government in foreign commerce, the *Container* Court only considered whether California's application of WWCR *violated* either one of two branches of the one voice standard, indicating that the state tax "will violate the 'one voice' standard if it *either* implicates foreign policy issues which must be left to the Federal Government [the dormant clause branch of the standard] *or* violates a clear federal directive." 463 U.S. at 194 (emphasis by the Court). Thus the only non-dormant Foreign Commerce Clause analysis in *Container* was a consideration whether the one voice had spoken to *preempt* California's use of WWCR. *Id.* In the words of the *Barclays* trial court, *Container* "did not address the question of whether such policy was expressed Congressionally *for* it." A-31 (emphasis by the court). The *Container* Court's consideration of "specific indications of

Three years after *Container*, in *Wardair*, this Court provided the analytic tool which, as properly applied by the California Supreme Court to uncontradicted facts in the current record, mandates the resolution of this reserved question in favor of California's use of WWCR. Noting that a *dormant* Commerce Clause analysis need not be applied when federal law indicates an authoritative federal decision to *permit* the challenged state tax, this Court held in *Wardair* that such a permissive decision can exist by *implication*, i.e., under circumstances where there is no explicit statement of such permission. Such "implications" are to be drawn from "the *law* as it presently stands," not from any "*aspiration*" for what the law might become. *Id.* at 10 (emphasis by the Court).

In *Wardair*, a Canadian airline challenged Florida's imposition of a tax on all aviation fuel sold within the state insofar as that tax was assessed on fuel used by foreign airlines exclusively in foreign commerce. On the Commerce Clause issue in *Wardair*,[4] the taxpayer and the

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congressional intent" (463 U.S. at 196) was restricted to the preemptive analysis, with the Court deciding that "we cannot conclude that the California tax at issue here is preempted by federal law. . . . " *Id.* at 197. Since the *Container* Court did not even consider whether the federal government's one voice had spoken to *permit* California's use of WWCR, it certainly is not inconsistent with *Container* to apply the later *Wardair* analysis in the present case to find such permission.

[4] The *Wardair* Court also held that the Florida tax was not preempted by the Federal Aviation Act, but the Court explicitly stated that it did not rely on a permissive provision of that act "to answer the Commerce Clause issue" present in *Wardair*. 477 U.S. at 6-7. Thus Barclays errs in implying (Pet. 21) that the Federal Aviation Act served in any way as a basis for the *Wardair* Commerce Clause holding.

Solicitor General as amicus curiae argued that the Florida tax unconstitutionally interfered with the ability of the federal government to speak with one voice because there was a federal policy to exempt such fuel from tax. As evidence of the alleged federal "policy," Wardair and the Solicitor General principally relied on (1) the Chicago Convention on International Civil Aviation, an international treaty to which the United States and 156 other countries, including Canada, are parties; (2) a resolution adopted by the International Civil Aviation Organization in 1966; and (3) more than 70 bilateral agreements into which the United States has entered with various countries dealing with international aviation. Discussing each of these in turn, this Court pointed out: (1) that the Chicago Convention by its terms precludes the imposition of local taxes on fuel only when the fuel already is on board an arriving aircraft, thus raising a "negative implication" that there had been "a decision by the parties to that convention to address the problem of [state and local taxation] by curtailing and limiting only some of the localities' power to tax, while implicitly preserving other aspects of that authority" (*id.* at 10); (2) that the resolution adopted by the ICAO, while it endorses an international scheme of tax exemption, is merely the work product of an international organization of which the United States is a member and has no force of law (*id.* at 11); and (3) that while most of the 70 bilateral agreements commit the United States to refrain from imposing national taxes of the type imposed by Florida, in none of these agreements has the United States agreed to deny the states the power to tax the sale of aviation fuel; in particular, the agreement between the United States and Canada makes *no*

mention of taxation by political subdivisions, "an omission which must be understood as representing a policy choice by the contracting parties. . . . " *Id.* at 11.

This Court went on to say:

> "What all of this makes abundantly clear is that the Federal Government has not remained silent with regard to the question of whether States should have the power to impose taxes on aviation fuel used by foreign carriers in international travel. By *negative implication* arising out of more than 70 agreements entered into since the Chicago Convention, the United States has at least acquiesced in state taxation of fuel used by foreign carriers in international travel. Again, in the U.S.-Canadian Agreement only 'national' charges are barred, and we presume that drafters from two federalist nations understood this as representing a choice not to preclude local taxation. It would turn dormant Commerce Clause analysis entirely upside down to apply it when the Federal Government has acted, and to apply it in such a way as to *reverse* the policy that the Federal Government has elected to follow." *Id.* at 12 (emphasis in original).

Thus in *Wardair* the federal government had considered whether to bar a type of tax practice by international agreement, but the *states* were not restricted from applying that tax practice when the agreements were finally adopted as a part of United States law. Under this Court's *Wardair* rule, the implications to be drawn from such an action establish that in formulating federal law Congress

has elected to permit the states to apply such a tax practice. *Id.* at 10, 12.[5]

In holding that the *Wardair* rule was applicable in the present case, the California Supreme Court placed its primary reliance on the United States/United Kingdom ("US/UK") Treaty which was negotiated and ratified in the 1970's. Convention for the Avoidance of Double Taxation and the Prevention of Fiscal Evasions with Respect to Taxes on Income and Capital Gains, Dec. 31, 1975, U.S./U.K., 31 U.S.T. 5668 (Exh. 40gg). For the first and only time, the federal Executive Branch negotiated a provision for that treaty, article 9(4), which would have explicitly prohibited any state's use of worldwide combined reporting ("WWCR"). C-29.

[5] It must be kept in mind that the United States Constitution gives the power to regulate foreign and interstate commerce to *Congress*. U.S. Const. art. I, § 8(3); Pet. App. F. Thus, as to foreign or interstate commerce matters, congressional action prevails over any conflicting actions or desires of the Executive Branch. See *United States* v. *Curtiss-Wright Export Corp.*, 299 U.S. 304 (1936); *United States* v. *Guy W. Capps, Inc.*, 204 F.2d 655 (4th Cir. 1953), aff'd on other grounds, 348 U.S. 296 (1955). If Congress has exercised its commerce powers so as to permit state action, there cannot possibly be any violation of the Commerce Clause. Once such permission is ascertained, "any action taken by a State within the scope of the congressional authorization is rendered invulnerable to Commerce Clause challenge." *Western & Southern L.I. Co.* v. *Bd. of Equalization*, 451 U.S. 648, 653 (1981); see also *Wardair*, 477 U.S. at 12-13. Given Congress' total power in regulating foreign and interstate commerce, in granting such permission Congress is unrestricted by any of the policy standards which would apply in a *dormant* Commerce Clause context.

After much debate, and several votes in the Senate, the treaty was only ratified after that provision was rendered totally inapplicable to the states. 124 Cong. Rec. 18416 (June 22, 1978) (Exh. 36c), 19076 (June 27, 1978) (Exh. 36d); C-29. After more bargaining with the United Kingdom, wherein the United Kingdom exacted other federal tax concessions from the United States, the United Kingdom accepted the treaty with the prohibition of WWCR only applicable to the national governments, not to the states. 31 U.S.T. 5709, 5713 (Exh. 40gg). Thus the states' use of WWCR was directly considered as a tax issue during the formulation of the treaty, but the *states'* use of WWCR ultimately was not restricted in the final adoption of the treaty as a part of United States law.

The US/UK Treaty provides a perfect context for the application of the *Wardair* rule: a clear congressional consideration of whether a state tax practice (WWCR) should be permitted, and a final ratification of a treaty which by clear implication permitted the states' application of that tax practice (WWCR). At the time of the final Senate vote, the clear and acknowledged choice before the Senate was either to ratify the US/UK treaty while permitting the states to use WWCR or (since ratification with original article 9(4) had proved impossible) not to ratify the treaty. See 124 Cong. Rec. 18709-12 (June 23, 1978) (statements of Senators Byrd, Church, Javits, Stevens, Sparkman, Cranston and Packwood (Exh. 36d). By more than the required two-thirds vote (82 yeas, 5 nays), the Senate chose to ratify the treaty while permitting (by implication) state use of WWCR. 124 Cong. Rec. 19076 (June 27, 1978) (Exh. 36d). In the words of the *Wardair* decision, the Senate has "at least acquiesced" in the use of WWCR by

the states, and under the *Wardair* holding such acquiescence is fully sufficient to establish that the federal government has "affirmatively decided to permit" state use of WWCR. 477 U.S. at 12-13.[6]

The California Supreme Court correctly analogized the present case to *Wardair*:

> "The parallels between this evidence of 'governmental silence' or refusal to act and that regarded as decisive in *Wardair, supra*, 477 U.S. 1, seem to us both evident and compelling. As in *Wardair*, an international agreement (here the bilateral income tax treaty between the United States and the United Kingdom) demonstrates that while federal executive branch officials *aspired* to eliminate a state tax practice (here the use of formula apportionment to calculate the tax liability of foreign-based multinationals), 'the *law* as it presently stands acquiesces' in the states' continued use of that practice. As in *Wardair*, the 'negative implications' of international agreements (here the tax treaty as ratified by the Senate) support recognition of a federal policy that *acquiesces* in the states' tax practice. And certainly, in the circumstances of Senate consideration detailed above, the explicit removal of 'political subdivisions' from the scope of article 9(4) effected by the Church reservation, like the omission of restrictions on taxation by political subdivisions in the international agreements considered in *Wardair*, 'must be understood as representing a policy choice by the contracting parties.' (*Wardair, supra*, 477 U.S. at p. 11." C-29 to C-30 (emphasis in original; footnote omitted).

[6] Contrary to Barclays' attempt to characterize the Senate's ratification of the treaty as a "stalemate" (Pet. 21 n. 21), the final outcome was a clear defeat for those who had attempted to bar precisely the type of state tax practice which Barclays is challenging in this case.

Recognizing that formula apportionment such as WWCR has been a matter of international interest from at least the mid-1950's (C-33 to C-34), and noting that indications of such federal acquiescence also were to be found in the history of other bilateral income tax treaties (C-31 to C-34) and in legislative histories of congressional bills (C-31), the California Supreme Court applied *Wardair* to hold that (1) California's application of WWCR in this case has been permitted by Congress under its Commerce Clause powers, and (2) since Congress has acted to permit such application, no dormant Commerce Clause analysis was necessary. Respondent Franchise Tax Board submits that one does not have to do more than apply the *Wardair* rule to the US/UK treaty to determine that the California Supreme Court's holdings were fully consistent with all current precedents of this Court. The California Supreme Court has not formulated and applied a "substitute test" of its own (see Pet. 11, 21, 23) to reach these holdings; it has correctly applied the test provided to it by this Court in *Wardair*.

A primary basis for Barclays' current petition is that the California Supreme Court somehow has gone beyond *Wardair* and other more recent decisions of this Court in holding that express Congressional permission is not necessary if the actions of Congress imply congressional acquiescence in a state tax procedure. Even if there could be any question on this point after *Wardair*, any such question must be deemed fully settled by this Court's

most recent decision involving the Foreign Commerce Clause: in *Itel Containers International Corp.* v. *Huddleston, supra,* decided on February 23 of this year, this Court concluded its Foreign Commerce Clause discussion with a holding that Congress had acted by inference to permit the Tennessee sales tax involved in that case. In *Itel,* consistently with *Wardair,* this Court inferred the congressional permission from the simple fact that the state tax did not fall within the types of taxes which had been eliminated in "various conventions, statutes and regulations that restrict a State's ability to tax international cargo containers in defined circumstances . . . . " 113 S.Ct. at 1105. The single-justice dissenting opinion in *Itel* criticized the majority for "finding congressional authorization for the tax in congressional silence," by "infer[ring] permission for the tax from Congress' supposed failure to prohibit it." 113 S.Ct. at 1110 (Blackmun, J., dissenting). This criticism is quite similar to the criticism of the *Wardair* majority opinion in the single-justice *Wardair* dissent; it is strikingly similar ~~to the criticism~~ which the Barclays petition has aimed at the California Supreme Court. While the Barclays petitioner may not like the *Wardair* approach, there can be no valid question that the California Supreme Court's application of the *Wardair* rule is fully consistent with the current rulings of this Court.

In the present case, the congressional permission is much more clearly manifested than what was held to be sufficient in *Itel*: here the congressional record clearly establishes that Congress had before it the specific proposal to eliminate the type of state tax procedures which are now at issue. By failing to attain the vote required by

the Constitution, that proposal was rejected by the Congress, and under *Wardair* that rejection is a part of the ratified U.S./U.K. Treaty's body of law under the Foreign Commerce Clause. Given the clarity and specific nature of the record in the present case as compared to the more generalized situation described in *Itel,* and given this Court's very recent decision applying the *Wardair* rule to the *Itel* facts, there is no need for this Court to reconsider the California Supreme Court's proper application of *Wardair.* The California court has not fashioned a new test of its own—it has simply applied the *Wardair* test in a manner which is totally consistent with this Court's February 1993 application of *Wardair* in *Itel.*[7]

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[7] The decision in *Itel* concluded its Commerce Clause holding by quoting from *Wardair*: " 'It would turn dormant Commerce Clause analysis entirely upside down to apply it where the Federal Government has acted, and to apply it in such a way as to *reverse* the policy that the Federal Government has elected to follow.' " 113 S.Ct. at 1105 (emphasis in original). Taxpayer/petitioner may try to argue that *Itel*'s quotation from *Wardair* somehow does not mean what the same clear language meant in *Wardair,* and that the essence of the *Itel* holding somehow rests on dormant Commerce Clause principles. This Court's Commerce Clause discussion in *Itel* does include analysis of dormant Commerce Clause elements, with references to *Japan Line, Ltd.* v. *County of Los Angeles,* 441 U.S. 434 (1979) and *Container, supra.* However, once the last, "one-voice," element was reached, this Court focussed on the possibility that Congress had acquiesced in the type of state tax which was at issue. Realizing, under *Wardair,* that such acquiescence would be determinative of the Commerce Clause issue, this Court noted that within the *Itel* context the Federal Government had acted on the subject matter (state taxation of cargo containers and their use) without proscribing the type of state tax which was directly at issue in *Itel.* Under those circumstances (and utilizing

II

THE DETERMINATION OF THE FOREIGN COMMERCE CLAUSE ISSUE IN THIS CASE PRECLUDES ANY FOREIGN AFFAIRS PREEMPTION ISSUE.

A foreign affairs pre-emption issue simply cannot be determinative in this foreign commerce context. It is clear that at the heart of the California Supreme Court's opinion is an issue pertaining directly to the Foreign Commerce Clause. It is undisputed that the Constitution gives to Congress alone the power "[t]o regulate commerce with foreign nations. . . . " U.S. Const. art. I, § 8(3). If, as the California Supreme Court has held, proper application of the *Wardair* rule in this case confirms that federal law pertaining to foreign commerce contains permission for the states' use of WWCR, then no contrary foreign affairs aspirations of the Executive Branch could eclipse

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the *Wardair* approach), this Court held in *Itel* that "the most rational inference to be drawn" is that the Tennessee Tax "is permitted." 113 S.Ct. at 1105. This is not a dormant Commerce Clause holding. If the Tennessee tax in *Itel* had *not* passed the tests of all of the dormant Commerce Clause elements which were considered, the *Itel* Commerce Clause result still would have been the same. This Court's reaffirmation of the *Wardair* holding and approach makes clear that the Tennessee tax still would have been upheld, because Congress, in *non*-dormant actions, impliedly permitted such a state tax. Any other result " 'would turn dormant Commerce Clause analysis entirely upside down.' " 113 S.Ct. at 1105. Furthermore, any claim by petitioner Barclays that *Itel* does not apply *Wardair* to reach its Commerce Clause holding based upon implied (rather than express) permission is refuted by the *Itel* dissenting justice's recognition (and criticism) that the majority "find[s] congressional authorization for the tax in congressional silence . . . . " 113 S.Ct. at 1110.

that permission. The Executive Branch's power in the field of foreign relations, " 'like every other governmental power, must be exercised in subordination to the applicable provisions of the Constitution.' " *Dames & Moore* v. *Regan*, 453 U.S. 654, 661 (1981), quoting *United States* v. *Curtiss-Wright Export Corp.*, 299 U.S. 304, 319-20 (1936).

But what of authorities such as *Hines* v. *Davidowitz*, 312 U.S. 52 (1941), and *Zschernig* v. *Miller*, 389 U.S. 429 (1968)? Barclays relies on these cases as barring any state act which has a direct impact upon foreign relations and which may well adversely affect the power of the central government to deal with foreign affairs issues. The answer in this case must be given in the foreign commerce context. If Congress has acted so as to permit state action in a foreign commerce context, no further authorization is needed, even though foreign relations necessarily are also involved. See *Wardair*, 477 U.S. at 12-13; see also *United States* v. *Guy W. Capps, Inc.*, 204 F.2d 655 (4th Cir. 1953), *aff'd on other grds.*, 348 U.S. 296 (1955).

Alternatively, in a dormant Foreign Commerce Clause context where no congressional acquiescence or prohibition is present, the *Container* decision teaches that a state tax at variance with the federal tax approach and affecting foreign commerce will violate the Foreign Commerce Clause if it " 'may impair federal uniformity in an area where federal uniformity is essential' . . . and 'prevents the Federal Government from "speaking with one voice" in international trade. . . . ' " 463 U.S. at 194. In reaching its Foreign Commerce Clause holding, the *Container* decision contains many references to "foreign affairs," "foreign relations," and "foreign policy" (see 463 U.S. at 189, 194, 195, 196, 197); it rejected the dissent's

position that California's application of WWCR was "an intrusion on national policy in foreign affairs that is not permitted by the Constitution." 463 U.S. at 206 (dissent). Thus, under *Container*, a dormant Foreign Commerce Clause holding in favor of WWCR includes consideration and determination of foreign affairs issues, leaving no room for any determination that the federal government's foreign affairs powers bar the application of WWCR to that taxpayer. This is consistent with the rule that the Congress and the President share authority over foreign affairs. See *Container*, 463 U.S. at 196; *Zschernig* v. *Miller*, 389 U.S. 429, 432 (1968). If a state tax affecting foreign commerce is valid either by way of congressional authorization or under the dormant Foreign Commerce Clause tests (which include the balancing of foreign policy considerations), it cannot be unconstitutional on the basis of infringement upon foreign affairs.

Application of Barclays' foreign affairs preemption argument in this case would also rewrite the treaty powers provisions of the United States Constitution. Congress, through the Senate's actions on the many bilateral income tax treaties, and through the Senate's action on article 9(4) of the US/UK Treaty, has taken affirmative action which allows the states to tax unfettered by separate accounting restrictions placed on the national government and unfettered by proposed article 9(4), and has therefore impliedly authorized state use of WWCR. This Court cannot construe the Executive Branch's foreign policy aspirations as authoritative federal policy without disabling not only Congress, but also the Constitution, which requires that treaties can become law only upon ratification by two-thirds vote of the Senate. U.S. Const.

art. II, § 2 (App. A hereto.) By rejecting the Executive Branch's 1970's aspirations which were given voice in proposed article 9(4) of the US/UK Treaty, Congress' implied acquiescence in the state use of WWCR has become a part of the "supreme law of the land" (U.S. Const. art. VI(2)); it cannot now be voided merely by relabeling the Executive Branch's thwarted aspirations as "foreign policy."

III

EVEN IF A DORMANT COMMERCE CLAUSE ANALYSIS WERE TO BE APPLIED, THERE WOULD BE NO VIOLATION OF THE DISCRIMINATION ELEMENT OF SUCH A DORMANT ANALYSIS.

As properly held by the California Supreme Court, under *Wardair*, once it is determined that Congress has acquiesced in the type of state taxation which is being challenged, there is absolutely no need for the courts to engage in any *dormant* Commerce Clause analysis. See above at p. 17.[8] Therefore, in this case there is no

[8] Given the Commerce Clause holding of the California Supreme Court, the only issue it remanded to the Court of Appeal was the Due Process Clause issue. After specifically noting that the Court of Appeal's first decision had not directly ruled upon the discrimination element in its dormant Commerce Clause analysis, the California Supreme Court ordered the remand so that the Court of Appeal could consider the merits of the due process issue "free of the view that a dormant foreign commerce clause analysis is appropriate in the circumstances present here." C-39. In spite of this guidance, the Court of Appeal engaged in unnecessary dormant Commerce Clause analysis, but it reached the correct conclusion that the

necessity for this Court to review petitioner Barclays' claim that California's application of WWCR resulted in a violation of the discrimination element of the dormant Commerce Clause analysis.[9]

Although its dormant Commerce Clause analysis was not necessary, the California Court of Appeal reached the correct conclusion as to the discrimination element. It correctly noted that under California law both foreign-based and domestic-based unitary groups "are treated the same—they face the same tax rate and must furnish the same kind of information." D-12. The fact that domestic groups, but not foreign-based groups, might also have to supply the same type of information to comply with United States tax laws does not inject discrimination into

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discrimination element of such an analysis would be satisfied here. D-6 to D-14.

[9] Barclays bases its discrimination argument on an allegation that it must either (1) incur enormous costs of setting up an additional accounting system solely for the purpose of properly preparing its California tax returns or (2) forgo tax benefits. The California Court of Appeal clearly has held that California law does not require any costly additional accounting system (furthermore, it requires nothing of Barclays that is not also required of domestic-based unitary businesses) (D-13 to D-25). As to tax benefits, the record in this case contains uncontested instances of the availability of tax benefits (such as depreciation and bad debts) within the California system's use of reasonable approximations and materiality. RT 1467-69, 1471-72. In any event, if the use of reasonable approximations somehow meant that tax benefits would become unavailable, the federal tax law's arm's-length method would fail in the same manner, for, as taxpayers' own expert witness testified, application of the federal system also depends on the use of reasonable approximations. RT 1270; see also 26 C.F.R. § 1.805-5(a)(4)(iv)(b).

the evenhanded California tax requirements. D-12 to D-14.

The Court of Appeal correctly relied upon this Court's recent decision in *Kraft General Foods* v. *Iowa Dept. of Revenue*, ___ U.S. ___, 112 S.Ct. 2365 (1992). In *Kraft* this Court held that an Iowa tax law discriminated against foreign commerce because "Iowa imposes a burden on foreign subsidiaries that it does not impose on domestic subsidiaries." *Id.* at 2371 (footnote omitted). This Court also noted that if a state's tax system "does not favor business activity in the United States generally over business activity abroad[,] . . . this would indeed suggest that the statute does not discriminate against foreign commerce." *Id.* at 2370. As recognized by the California Court of Appeal, California applies exactly the *same* tax and information requirements to all businesses, whether they have foreign connections or solely domestic connections. The fact that the Barclays group does not have to meet certain United States *federal* tax accounting requirements which domestic groups must fulfill separately from the California requirements, does not render California's law discriminatory as to members of the Barclays group. See *Cotton Petroleum Corp.* v. *New Mexico*, 490 U.S. 163, 189 (1989), where this Court held that New Mexico's taxes were not unconstitutionally discriminatory:

> "The burdensome consequence is entirely attributable to the fact that the [taxable activities] are located in an area where two governmental entities share jurisdiction. . . . [T]he New Mexico

taxes are administered in an evenhanded manner and are imposed at a uniform rate throughout the State . . . . "[10]

In any event, once it is determined that a state tax is not discriminatory on its face, the discrimination element of the dormant Commerce Clause analysis is satisfied if the tax is fairly apportioned. *Trinova Corp.* v. *Michigan Dept. of Treasury*, ___ U.S. ___, 111 S.Ct. 818, 835 (1991). In this case, consistent with this Court's holding in *Container* that the California tax system provides for fair apportionment of taxable income (463 U.S. at 180-84; see also above at pages 7-8), the Barclays taxpayers have stipulated that they are not challenging the fairness of California's apportionment of income under WWCR. RT 1551. Under these circumstances, no discrimination is present for purposes of dormant Commerce Clause analysis.

IV

CALIFORNIA'S APPLICATION OF WORLDWIDE COMBINED REPORTING TO THE BARCLAYS TAXPAYERS DID NOT VIOLATE DUE PROCESS.

After holding that Congress had exercised its Commerce Clause powers to permit California's use of WWCR, and having thus determined that no dormant Commerce Clause analysis could alter that permission,

[10] The California Court of Appeal correctly distinguished the *Barclays* context from such cases as *Hunt* v. *Washington State Apple Advertising Comm'n*, 432 U.S. 333 (1977), on the basis that in *Barclays* foreign-based multinationals and domestic-based multinationals "must both furnish the same kind of information." D-11, n. 4.

the California Supreme Court remanded the case to the California Court of Appeal for determination of the due process issues. C-38 to C-39. The Court of Appeal then confirmed that California law provides for (1) the avoidance of oppressive costs of compliance through the use of reasonable approximations and the principle of materiality (D-13 to D-14, D-20 to D-21, D-23 to D-24) and (2) judicial review of any claimed abuses of discretion by the taxing agency in the application of this procedure (D-21, D-23). On the basis of its construction of California law, the Court of Appeal held that there was no violation of due process in this case. D-27. The California Supreme Court denied Barclays' petition for review of this construction and holding. E-1.

This Court has held that it is not free to overturn the California Court of Appeal's constructions of California state law when the California Supreme Court has denied review of the case. *Hicks* v. *Feiock*, 485 U.S. 624, 629-30 (1988). Nevertheless, petitioner Barclays raises an empty claim that the challenged California regulation is not explicit enough, that "enforcement rests in the effectively standardless discretion of the administering agency." Pet. 30. Given the California court's carefully circumscribed construction of regulation 25137-6 (Pet. App. J),[11] given

[11] "[T]he Board must consider the cost and effort of producing WWCR information in deciding whether to accept reasonable approximations, and that consideration is to use regularly-maintained or other readily-accessible corporate documents as the cost guideline." D-21. "[T]he Board's discretion regarding reasonable approximations is circumscribed and guided by our interpretation of section 25137-6(e)(1)'s mandatory consideration of cost and effort." D-23.

this Court's established endorsement of the standard of "reasonable" as providing sufficient and appropriate guidance in the due process area,[12] and given the total lack of any showing that there was any abuse of discretion in the final administrative result in this case, petitioner's due process argument would necessarily fail on the merits. No due process ground of any substance exists for review in this Court.

CONCLUSION

For the reasons given above, it is respectfully submitted that the petition for writ of certiorari should be denied.

Dated: April 23, 1993.

Respectfully submitted,

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[12] See D-22, citing, *inter alia, United States* v. *Ragen*, 314 U.S. 513, 522-24 (1942).

APPENDIX A

CONSTITUTIONAL AND STATUTORY PROVISIONS

UNITED STATES CONSTITUTION

Article II, section 2, clause 2 (in part):

> [The President] shall have power, by and with the advice and consent of the Senate, to make treaties, provided two-thirds of the Senators present concur. . . .

CALIFORNIA REVENUE AND TAXATION CODE

Section 25110 (water's-edge election):

(a) Notwithstanding Section 25101, a qualified taxpayer, as defined in paragraph (2) of subdivision (b) which is subject to the tax imposed under this part, may elect to determine its income derived from or attributable to sources within this state pursuant to a water's-edge election in accordance with the provisions of this part, as modified by this article. A taxpayer which makes a water's-edge election shall take into account the income and apportionment factors of the following affiliated entities only:

(1) Affiliated banks or corporations which are eligible to be included in a federal consolidated return as described in Sections 1501 to 1505, inclusive, of the Internal Revenue Code, other than corporations making an election under Section 936 of the Internal Revenue Code.

(2) Domestic international sales corporations, as described in Sections 991 to 994, inclusive, of the Internal Revenue Code and foreign sales corporations as

described in Sections 921 to 927, inclusive, of the Internal Revenue Code.

(3) Any corporation, regardless of the place where it is incorporated if the average of its property, payroll, and sales factors within the United Sates is 20 percent or more.

(4) Banks and corporations which are incorporated in the United States, excluding corporations making an election pursuant to Sections 931 to 936, inclusive, of the Internal Revenue Code, of which more than 50 percent of their stock is controlled directly or indirectly by the same interests, which are not included in paragraph (1).

(5) A bank or corporation which is not described in paragraphs (1) to (4), inclusive, or paragraph (6), but only to the extent of its income derived from or attributable to sources within the United States and its factors assignable to a location within the United States in accordance with paragraph (3) of subdivision (b). Income of such a bank or corporation derived from or attributable to sources within the United States as determined by federal income tax laws shall be limited to and determined from the books of account maintained by the bank or corporation with respect to its activities conducted within the United States.

(6) Export trade corporations, as described in Sections 970 to 972, inclusive, of the Internal Revenue Code.

(7) Any affiliated bank or corporation which is a "controlled foreign corporation", as defined in Section 957 of the Internal Revenue Code, if all or part of the income of that affiliate is defined in Section 952 of Subpart F of the

Internal Revenue Code ("Subpart F income"). The income and apportionment factors of any affiliate to be included under this paragraph shall be determined by multiplying the income of and apportionment factors of that affiliate without application of this paragraph by a fraction (not to exceed one), the numerator of which is the "Subpart F income", of that bank or corporation for that income year and the denominator of which is the "earnings and profits" of that bank or corporation for that income year, as defined in Section 964 of the Internal Revenue Code.

(8) (A) The income and factors of the above-enumerated banks and corporations shall be taken into account only if the income and factors would have been taken into account under Section 25101 if this section had not been enacted.

(B) The income and factors of a bank or corporation which is not described in paragraphs (1) to (4), inclusive, and (6) and which is an electing taxpayer under this subdivision shall be taken into account in determining its income only to the extent set forth in paragraph (5).

(b) For purpose of this article and Section 24411:

(1) An "Affiliated bank or corporation" means a bank or corporation which is related to a bank or corporation, required to file under this part, because of any of the following:

(A) It owns directly or indirectly more than 50 percent of the voting stock of the bank or a corporation required to file under this part.

(b) More than 50 percent of its voting stock is owned directly or indirectly by a bank or corporation required to file under this part.

(c) More than 50 percent of voting stock of both it and the bank or corporation required to file under this part is owned or controlled directly or indirectly by any bank or person (as defined in Section 7701(a)(1) of the Internal Revenue Code).

(2) A "qualified taxpayer" means a bank or corporation which does both of the following:

(A) Files with the state tax return on which the water's-edge election is made a consent to the taking of depositions at the time and place most reasonably convenient to all parties from key domestic corporation individuals and to the acceptance of subpoenas duces tecum requiring reasonable production of documents to the Franchise Tax Board as provided in Section 26423 or by the State Board of Equalization as provided in Title 18, California Code of Regulations, Section 5005, or by the courts of this state as provided in Chapter 2 (commencing with Section 1985) of Title 3 of Part 4 of, and Section 2025 of, the Code of Civil Procedure. The consent relates to issues of jurisdiction and service and does not waive any defenses a taxpayer may otherwise have. The consent shall remain in effect so long as the water's-edge election is in effect and shall be limited to providing that information necessary to review or to adjust income or deductions in a manner authorized under Sections 482, 861, Subpart F of Part III of Subchapter N, or similar provisions of the Internal Revenue Code, together with the regulations adopted pursuant to those provisions, and for the conduct of an investigation with

respect to any unitary business in which the taxpayer may be involved.

(B) Agrees that for purposes of this article, dividends, received by any bank or corporation whose income and apportionment factors are taken into account pursuant to subdivision (a) from either of the following are functionally related dividends and shall be presumed to be business income:

(i) A bank or corporation of which more than 50 percent of the voting stock is owned, directly or indirectly, by members of the unitary group and which is engaged in the same general line of business.

(ii) Any bank or corporation which is either a significant source of supply for the unitary business or a significant purchaser of the output of the unitary business, or which sells a significant part of its output or obtains a significant part of its raw materials or input from the unitary business. "Significant," as used in this subparagraph, means an amount of 15 percent or more of either input or output.

All other dividends shall be classified as business or nonbusiness income without regard to this subparagraph.

(3) The definitions and locations of property, payroll, and sales shall be determined under the laws and regulations which set forth the apportionment formulas used by the individual states to assign net income subject to taxes on or measured by net income in that state. If a state does not impose a tax on or measured by net income or does

not have laws or regulations with respect to the assignment of property, payroll, and sales, the laws and regulations provided in Article 2 (commencing with Section 25120) shall apply.

Sales shall be considered to be made to a state only if the bank or corporation making the sale may otherwise be subject to a tax on or measured by net income under the Constitution or laws of the United States, and shall not include sales made to a bank or corporation whose income and apportionment factors are taken into account pursuant to subdivision (a) in determining the amount of income of the taxpayer derived from or attributable to sources within this state.

(4) "The United States" means the 50 states of the United States and the District of Columbia.

(c) All references in this part to income determined pursuant to Section 25101 shall also mean income determined pursuant to this section.